Examiner's report

FA2 Maintaining Financial Records
For CBE and Paper exams covering July to December 2013

General Comments

The intention of this report is that, when considered in conjunction with previous reports, candidates at future sittings will have a resource which maximises their chance of success. The most effective way to use these reports is to consider both the technical content of each question, and the approach to answering the question – noting that different question types will require slightly different approaches.

In considering the technical content, candidates should make sure that they have a clear understanding of that content. While not every candidate will use exactly the same approach, it is important to ensure that a logical and sequential approach is applied, based on relevant technical knowledge.

Sample Questions for Discussion

Example 1

Amit buys machines, which he repairs and then sells. He has the following information about a machine which is being repaired at 30 November:

Cost of machine	$17,130
Cost of repairs to date	$ 2,465
Cost of further repairs before sale	$ 1,720
Expected sale proceeds	$21,160

What is the inventory value of the machine in Amit's statement of financial position at 30 November?

A $19,595
B $16,975
C $21,315
D $19,440

This question tested candidates' ability to apply the key requirement of IAS 2 – that 'inventories should be measured at the lower of cost and net realisable value'. IAS2 goes on to provide definitions of both cost ('all costs …. incurred in bringing the inventories to their present location and condition') and net realisable value ('estimated selling price … less the estimated costs of completion and the estimated costs necessary to make the sale).

The definitions in the standard could be simplified as follows:

Cost = all costs <u>that have been</u> incurred up to the date of the statement of financial position
NRV = selling price less cost that <u>will be</u> incurred after the date of the statement of financial position

Using the data in the question, costs of $17,130 and $2,465 have been incurred, so the cost of the machine is $19,595.

The estimated selling price is $21,160 and estimated costs to be incurred are $1,720, so the net realisable value is $19,440. As this is lower than cost, the machine should be valued at $19,440. Thus, the answer is D.
Candidates who selected A had correctly calculated cost, but did not apply the rule that this value should only be used if it is less than net realisable value.

Candidates who selected C did not recognise that only those costs which have already been incurred should be included in the calculation of cost (as costs which have yet to be incurred were included), while those candidates who selected B incorrectly included costs which have already been incurred in their calculation of net realisable value

Example 2

A reconciliation between Ethan's non-current asset register and his general ledger has identified an asset which is recorded in the general ledger, but is not recorded in the non-current asset register.

Which of the following could explain this discrepancy?

(1) the ledger entries to record the sale of an asset have been completed, but the register has not been updated
(2) no record was made when an asset was scrapped

A Both 1 and 2
B Neither 1 nor 2
C 1 only
D 2 only

When attempting a question of this type the best approach is, first to read and understand the introductory information which sets the context, and then to consider each statement individually.

The introductory information tells us that an asset is in the general ledger, but not in the asset register. That means that either:

an asset has been added to the general ledger, but not to the asset register; or
an asset has been removed from the asset register, but not from the general ledger

Statement 1 describes a situation in which an asset has been removed from the general ledger, but not from the asset register, so it could NOT explain the discrepancy.

In the case of statement 2, the asset has not been removed from either the general ledger or the asset register. This means that the two records agree, but both are wrong, so this statement could NOT explain the discrepancy.

Thus the correct answer is B.

Candidates who selected any of the incorrect choices appear to have misinterpreted some of the information and / or not thought carefully about what was communicated in the question.

This kind of question clearly illustrates the need for candidates to read the question carefully and to think carefully and logically before choosing their answer.

Example 3
When Amir prepared his draft final accounts, he overstated an accrual by $690 and understated a prepayment by $430.

What is the effect of these errors on Amir's capital balance?

A An understatement of $260
B An understatement of $1,120
C An overstatement of $1,120
D An overstatement of $260

To answer this question correctly, candidates needed to be clear on how the capital balance is affected by both an accrual and a prepayment. In essence, this meant applying the accounting equation correctly.

The accounting equation states: assets – liabilities = capital.

If each piece of information in the question is considered in turn and the necessary adjustment identified, the answer can be worked out as follows.

First, an accrual has been overstated by $690. This means that the accrual needs to be reduced. An accrual is a liability, so the impact of the overstatement was to understate capital by $690.

Second, a prepayment has been understated by $430. This means that the prepayment must be increased. A prepayment is an asset, so assets, and thus capital, have been understated by $430.

If this is applied to the accounting equation, it follows that capital has been understated by $1,120, making B the correct answer.

It seems reasonable to argue that those candidates who did not select B had not read the question carefully enough, or did not deal with the information logically and sequentially.

Candidates who selected A dealt correctly with the overstatement of the accrual, but interpreted the impact of the error in the prepayment as <u>over</u>stating capital.

By selecting C, candidates who selected dealt incorrectly with both errors, treating them both as leading to an overstatement of capital.

In choice D, the error in the prepayment was correctly dealt with, but the error in the prepayment was treated as leading to an overstatement of capital.

Summary
Based on the performance of candidates in these questions, it can be observed that there were two major reasons for incorrect choices being made.

The first is that there was a lack of awareness / understanding of fundamental issues in the syllabus (eg valuation of inventory and the accounting equation). The second is that the questions were not read carefully enough, which led to confused thinking.

These are the two reasons which have been highlighted in reports for every previous sitting. Candidates preparing for future sittings are strongly encouraged to ensure that they have developed a clear understanding of the key points of each area of the syllabus and that they read carefully and think logically when attempting questions.